



## CESEC 2.0: Opening the door to a new level of regional cooperation

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### Summary

The Central and South-Eastern Europe Gas Connectivity (CESEC) initiative brings together EU and non-EU countries under a single regional framework promoting energy policy cooperation. All states in the region share common challenges in the areas of energy security and energy market development that can best be addressed via a joint regional approach.

To date, the initiative has been a major political success for all those participating – the European Commission, the member states and the Energy Community contracting parties – which together have taken ambitious steps towards the creation of a regional energy security framework on the back of a regional energy market. Essential elements include the high-level political commitment, the prioritisation of a limited number of key infrastructure projects and the smart mobilisation of available EU funding.

These accomplishments are relevant for the successful implementation of the initiative's next phase, CESEC 2.0, which will see its extension to electricity markets, renewables and energy efficiency, for which the high-level meeting in Bucharest on 27-28 September 2017 is expected to lead the way.



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## 1. Introduction

The countries of Central and South-Eastern Europe have traditionally shown a vulnerability to security of energy supply, and notably gas, as revealed in the European Commission's stress tests in 2014. The cancellation of the South Stream gas pipeline project that same year, reinforced by the changing geopolitical landscape, created a strong political momentum to address this vulnerability through cooperation at the regional level. Accordingly, the Energy Union has given priority to regional energy policy cooperation, with special reference to South-East Europe, and placed infrastructure at its core, as formulated *inter alia* in the 2014 European Energy Security Strategy.

These developments led the European Commission in February 2015 to launch a high-level regional energy policy cooperation initiative – Central and South-Eastern Europe Gas Connectivity (CESEC) – to address the diversification of natural gas and the challenges of security of supply. CESEC has grown into an important pillar for security of supply, infrastructure and market integration within the EU and the Energy Community. It has made an important contribution towards improving overall EU and European energy security by strengthening one of the most vulnerable regions.

CESEC produced an Action Plan, which identified projects to diversify gas supply in the region. Initially, the focus was on creating interconnectors through a limited number of infrastructure projects to supply gas when and where needed. The progress that followed saw the immediate implementation of seven projects (out of twenty proposed) with a strong relevance to the region, and reverse flow agreements were subsequently signed in September 2016. Attention is now shifting to 'software', in the form of rules to ensure market functioning (reverse flows, setting cross-border tariffs and capacity allocation). Progress in these areas is being made at the technical level.

Following the successes of the first stage of operation, the CESEC High-Level meeting in Budapest in September 2016 agreed the expansion of the CESEC scope beyond natural gas and proposed the establishment of two new working groups, one on the "cost-effective development of renewable energy and energy efficiency in the region" and the other on "an efficient, well-connected electricity market". The CESEC High-Level meeting in Bucharest in September 2017 will sign the "Memorandum of Understanding complementing the CESEC initiative with a Joint approach on electricity market, energy efficiency and renewable development", which contains the new Action Plan on these concrete areas and terms of reference for collaboration.

This paper takes stock of the progress achieved so far and highlights the implementation of the new phase of regional cooperation through the CESEC high-level meeting in Bucharest.

## 2. Achievements of CESEC 1.0: Regional cooperation for more secure and affordable gas volumes in the region

For future steps, CESEC further can build upon solid achievements of the first phase:

- From the outset CESEC managed to achieve a good balance between initiating projects that originated in and reflected the priorities of the member countries on the one hand, and meeting the EU's requirement to identify and develop missing infrastructure and provide the necessary market rules for the creation of an integrated regional market, on the other.
- A precondition for a workable framework has been a geographical definition or delimitation of the region. CESEC has managed to bring together a group of countries from Central and South-East Europe into a common and effective framework for cooperation on energy.
- By combining EU member states and Energy Community countries into one single framework, CESEC not only reflects the fact that interconnectivity does not stop at the EU borders, but also acknowledges that all countries in the region share common energy security and energy market challenges as well as future opportunities<sup>1</sup> and potential solutions. CESEC notably managed to avoid a situation of creating 'ins' and 'outs', which would appear to be a precondition for sustainable long-term cooperation.
- A factor of success was the focus on tangible and practical 'projects', i.e. the activities, groups of countries or the entire group worked on projects they found beneficial. This was reinforced by the fact that CESEC solicited external expertise.
- On the infrastructure side, the interconnection between Bulgaria and Romania was completed in 2016 and will reach its maximum capacity by end 2019, when Phase I of the Connecting Europe Facility co-funded corridor Bulgaria-Romania-Hungary-Austria (BRUA) will be completed on the territory of Romania. This project has a crucial regional dimension since it physically integrates the Southern Gas Corridor with the Central and Western European markets.
- A Memorandum of Understanding was signed on 20 June 2017 between the Republic of Croatia and Hungary on reverse flows, enabling the bidirectional use of their interconnection point and setting the stage for LNG deliveries from Croatia to Hungary in the mid-term, thus increasing the diversification options for the region thanks to the Krk LNG terminal.

With these accomplishments, CESEC 1.0 established a framework with a defined group of countries from the region, bringing together EU member states and non-EU countries under a single framework. Concentrating on practical projects that reflected the common interests worked well, leading to tangible progress. The focus on energy security provided direction and enabled the members to maintain a consensus.

To date, CESEC 1.0 has been successful in taking important steps towards the creation of a regional market thanks to high-level political commitment, prioritisation of a limited number of key infrastructure projects and the smart mobilisation of available EU funding.

All these successes together bode well for a deepening and widening of the process, which is underway through the enlargement to electricity markets, renewables and energy efficiency.

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<sup>1</sup> There is, for example, high potential for renewables and hydropower development and dealing with the challenges of aging lignite, an underdeveloped gas network, dependency on a single supplier, etc. Confronting shared problems has helped to bring the alliance closer together.

### 3. Extending the scope of regional cooperation: CESEC 2.0

Following the decision taken at the CESEC High Level Group meeting in September 2016 to extend cooperation from gas into new areas, two new working groups were established, charged with i) creating a regional electricity market, including the necessary infrastructure, and ii) boosting renewable energy and energy efficiency in the region. The working groups have met regularly since December 2016 and agreed specific goals and concrete actions to be achieved in each field. These goals have now been included in a new Memorandum of Understanding (MoU), and the concrete actions necessary for their implementation appear in a dedicated draft Action Plan. The new MoU builds upon the earlier CESEC MoU signed in 2015, but distinctively addresses the new areas of cooperation.

The High-Level CESEC meeting in Bucharest will sign the “Memorandum of Understanding complementing the CESEC initiative with a Joint approach on electricity market, energy efficiency and renewable development”. The new Memorandum of Understanding reflects a political intent but it does not establish any new legal commitments nor does it replace or modify any existing legal obligations for the signatories.

The extended scope of responsibilities of the CESEC initiative is developed in a new Action Plan covering the following areas:

#### a. Electricity markets, infrastructure and security of electricity supply

Five priority projects for trading and coupling electricity markets<sup>2</sup> between the EU and Energy Community Contracting Parties will be launched with the aim of developing a larger, more liquid and competitive energy market in the region.

These projects will link the EU electricity market with the Western Balkans 6 region, establishing trading arrangements and close working relationships to integrate them into the EU market. These projects are the first steps towards ending the isolation of Balkan electricity markets while supporting decarbonisation and security of supply at lower costs to consumers.

At the same time, six priority projects in electricity infrastructure<sup>3</sup> among the Projects of Common Interest (PCI), Projects of Energy Community Interest (PECI) and Projects of Mutual Interest (PMI) have been identified. These projects aim to enhance cross-border transmission capacities, electricity interconnections, smart grids and infrastructure support for Energy Community Contracting Parties to integrate into the European electricity market. The work is now moving to the implementation phase and, once implemented, these projects will enhance the regional transmission capacity, notably by connecting EU Member States and Energy Community Contracting Parties in an integrated regional South-East European market.

<sup>2</sup> Italy-Montenegro-Serbia; Bulgaria-Romania-Greece + accession stream for future WB6 partners with Croatia and Italy; Croatia-Bosnia & Herzegovina; Serbia-4M(CZ-SK-HU-RO); Romania-Bulgaria-Greece+WB6.

<sup>3</sup> Enhancement of the cross-border transmission capacity between Bulgaria, Romania and Greece; Reinforcement of the interconnection between Bulgaria and Romania (“Black Sea Corridor”) comprising two internal reinforcements projects in Romania and one in Bulgaria; Enhancement of the transmission capacity along the East-West corridor in South-East Europe from Italy to Romania via the Balkans; Electricity Interconnections Hungary-Slovakia; Infrastructure supporting the integration of Ukraine and Moldova power systems into European electricity market; Croatia-Hungary-Slovenia Interconnection; and Slovenia-Croatia Smart Grids.

Last but not least, the security of electricity supply, including cyber-security, in the region is to be strengthened. In order to safeguard security of electricity supply, various prevention and management measures for crisis situations have been proposed. The transmission system operators in the CESEC region should in due time meet the obligations set out in the network codes and guidelines, such as adopting system defence plans and setting up regional security centres.

#### **b. Renewable energy**

As the International Renewable Energy Agency (IRENA) has documented on various occasions,<sup>4</sup> there is an untapped economic potential for more wind and solar capacity. Some countries in Central and South-East Europe (C&SEE) have a proven record in integrating renewables into the grid, in some cases far beyond the EU average. These EU member states can provide experiences and lessons for non-EU CESEC member states on renewables deployment.

Therefore, as regards renewable energy, the new Action Plan proposes to assess the renewable energy potential in the region by 2030 and 2050, promoting best practices and financing tools for the development of renewable energies and the reduction of non-financial barriers. It also proposes to foster renewable deployment through actions related to energy efficiency. A particular focus is put on the promotion of financial instruments for renovating buildings and small-scale renewable deployment.

CESEC intends to focus on promoting and assessing the regional onshore and offshore potential of renewables, the benefits of a regional approach and best practices on financing and support instruments.

#### **c. Energy Efficiency**

Energy efficiency is now established as a policy priority in the region. With C&SEE on the verge of finding practical solutions in the area of energy efficiency, CESEC is well placed to assist in this process on a regional level.

There are benefits in sharing information, experiences and best practices in order to effectively use public funds, leverage public investment, support project investment in non-EU countries and fight against energy poverty. For these reasons, the new Action Plan proposes to exchange information, experience and best practices on:

- Financing and the use of financial instruments to mobilise private financing
- Deployment of Project Development Assistance mechanisms to support the development of project pipelines, and
- Benchmarking activities on energy efficiency practices (e.g. energy efficiency measures to address energy poverty).

Indeed, there are many common challenges in the region but also a wealth of experience in different C&SEE and EU member states on how to address them. There is a case to build upon each experience by establishing and operating platforms for best-practice. A platform for energy efficiency might be a good starting point.

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<sup>4</sup> IRENA, Joanneum Research and University of Ljubljana 2017), “Cost-Competitive Renewable Power Generation: Potential across South East Europe”, International Renewable Energy Agency (IRENA), Abu Dhabi, 2017.

## 4. Governance of CESEC 2.0

For purposes of extending regional cooperation to electricity, renewables and energy efficiency, the Memorandum proposes the following adjustments to CESEC's governance:

- 1) Extend the geographical scope to cover Kosovo and Montenegro;
- 2) Increase the involvement of the Energy Community Secretariat in the regional cooperation; and
- 3) Organise the work around a steering group and technical sub-groups. While the High-Level (Steering) Group is common to all areas of CESEC regional cooperation – gas, electricity, renewables and energy efficiency – technical sub-groups are created for the new areas (namely one sub-group for electricity trading and security of supply, one for electricity infrastructure and one for renewables and energy efficiency) and involve the participation of stakeholders. Securing their interest and support will be key to the success of the regional cooperation.

## 5. The Potential of CESEC 2.0

The energy sector still faces many challenges that can be addressed through regional frameworks such as CESEC, to ensure that the region progresses together, benefitting from scale and cross-border exchanges and trade.

A fundamental and ongoing task of CESEC is to effectively address the diversification of natural gas and security of supply. Through the extension of its mandate to electricity, CESEC can improve cooperation among member states in preventing, preparing for and managing electricity crises. The vulnerability highlighted by the cold spell in January 2017 places CESEC in an optimal position to help in the implementation of system operation guidelines and the risk-preparedness regulation.<sup>5</sup> In addition, the inclusion of electricity offers the opportunity to better integrate electricity and gas networks, which has been shown<sup>6</sup> to be a cost-efficient and effective tool to increase security of supply, and which is being acknowledged by an increasing number of Member States in coping with the challenges of the energy transition.

Beyond energy security, the other important opportunity that the implementation of the new CESEC mandate offers is the potential to harness additional funding, especially from private sources. Addressing the region's energy security challenges as well as guiding the gradual transition to the "infrastructures for the future" require considerable financial investment, which public funding alone cannot meet. A first immediate challenge will be to leverage additional finance to meet the EU's co-financing requirement. CESEC has proved its potential in leveraging smart finance in the natural gas sector. By extending CESEC to electricity, renewables and energy efficiency, we should expect a similar benefit. A dynamic CESEC increases predictability and investor certainty, a condition for the engagement of EU and international finance institutions as well as private investors.

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<sup>5</sup> For more, see A. Hassel, C. Stroia, C. Egenhofer, J. Jansen and A. Behrens, "Improving Cooperation among EU Member States in Handling Electricity Crises. Lessons for the Regulation on risk-preparedness", CEPS Policy Insights, CEPS, Brussels, July 2017 (<https://www.ceps.eu/publications/improving-cooperation-among-eu-member-states-handling-electricity-crises-lessons>).

<sup>6</sup> See, for example, J. Gaventa, M. Dufour and L. Bergamaschi, "More Security at Lower Cost: A smarter approach to gas infrastructure in Europe", Energy Union Choices, Brussels, March 2006.

CESEC can help to improve and develop the necessary administrative capacity and good fund management to efficiently raise and manage funds, especially the combination of EU grants, EIB financial instruments and other funding sources. Holding a key role as a facilitating platform, CESEC is well placed to invite and encourage international financial institutions to invest in the region and tap into its potential.

CESEC can build upon the region's large technical and digital competences in the new areas of the mandate (electricity, renewables and energy efficiency). All countries from the region have a strong engineering culture with a wealth of technical talent due to the area's solid engineering, math and sciences universities. C&SEE is the cradle of the European fossil fuel industry with proven engineering expertise. Several countries in C&SEE have extensive knowledge of and experience with renewable energy, such as hydro but also solar and wind, as well as energy-efficiency projects. In the context of implementing the new CESEC mandate, the region's technical and digital competences, along with the potential for research and development, provide a strong advantage, but one that will need a facilitating framework to yield their full potential.

The Energy Union covers five closely related and mutually reinforcing dimensions: 1) security, solidarity and trust, 2) a fully-integrated internal energy market, 3) energy efficiency, 4) climate action – decarbonisation of the economy and 5) research and innovation. The latter is a horizontal dimension, which connects the previous four to drive security of supply, the transition of the energy system and competitiveness. The Energy Union explicitly provides for regional cooperation and mentions South East Europe. CESEC has the potential to become a success story of the Energy Union strategy, transcending the EU and Energy Community borders.

Regional cooperation is gaining relevance in the current context of Central and South East Europe. The upcoming Bulgarian Presidency of the EU Council in the first half of 2019 has already singled out the enhancement of regional cooperation as one of its priorities, and within this framework, CESEC is an example of best practices in political collaboration in energy areas that cover natural gas, electricity, renewables and energy efficiency.

## 6. Conclusion

Having grown out of a crisis – in parallel with the EU – CESEC has flourished in its brief existence and become a best practice. With a new and expanded mandate, CESEC offers added opportunities to the region of Central and South East Europe. Seizing these opportunities will require CESEC to build on its strengths and take an ambitious stance towards all dimensions of the Energy Union, including research and innovation.

Research and innovation, technology, industrial development and increasingly self-sustained financing will enable Central and South East Europe to develop local and regional cost-effective solutions, often based on digital technology, to optimise the energy network infrastructure across the region, to reduce primary energy demand and develop new and endogenous sources while enabling economic growth, jobs and prosperity in the region. The energy transition, which is underway globally will also require new thinking for the planning of the infrastructures of the future, which go beyond national borders and single fuels.

CESEC is the essential framework in which to discuss all current and future issues between the EU and the Energy Community Contracting Parties. The meeting in Bucharest opens the door to a new phase of regional cooperation through the implementation of the extended CESEC mandate that now includes electricity, renewables and energy efficiency.